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RUEHLP/AMEMBASSY LA PAZ 3512
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UNCLAS SECTION 01 OF 03 SAO PAULO 000832

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TREASURY FOR JHOEK
USDOC FOR 4332/ITA/MAC/WH/OLAC
USDOC ALSO FOR 3134/USFCS

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TAGS: EFIN ECON BR
SUBJECT: CREDIT GROWTH IN BRAZIL DRIVING ECONOMIC GROWTH

REF: SAO PAULO 709

Summary

¶1. (U) Credit growth in Brazil is one of the major drivers of economic growth despite some of the highest real interest rates in the world. Overall credit availability is up 25 percent over the last 12 months, especially in personal consumer credit and much of this growth is attributed to rising incomes and business confidence. New forms of credit are also bringing traditionally excluded lower income Brazilians into the credit market; however, this sector represents a significant risk of default. As the regulatory framework in Brazil doesn't adequately protect banks against these default risks, the result is higher interest rates. Overall, economic analysts in Sao Paulo view Brazil's credit expansion as positive; however, Brazil needs to strengthen the ability of banks to review and share an applicant's credit history and credit checks to ensure credit expansion remains a positive economic tool. End Summary.

Brazil's Credit Booming, But Still Relatively Small
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¶2. (U) Credit growth in Brazil is expanding quickly despite the recent sub-prime credit turmoil in the U.S. (reftel). The Central Bank's (CB) August bank lending data shows that Brazil's overall credit volume has expanded by 25 percent over the last 12 months. Total lending as a percent of GDP in Brazil was 33 percent in 2007, up 10 percent from January 2004, and the CB forecasts continued growth to about 40 percent of GDP by the end of 2009. However, Brazil's share is still small relative to other countries such as Malaysia, China, and Thailand where lending as a percent of GDP is nearly 100 percent.

¶3. (U) Brazilians are buying a rising share of goods with credit, including cars, clothes, food, small household appliances,

electronics, and real estate. Personal credit was responsible for 40 percent of credit growth in 2007 through August. Automobile leases and real estate mortgages over the last 12 months are up 80 and 74 percent respectively. [Note: Mortgages in Brazil only represent 1.6 percent of Brazil's overall GDP, compared with 60 percent of GDP in the U.S. End Note.] Retail stores also are introducing store-specific credit cards, supplying the market with even greater access to credit. According to Rodrigo Mariano, an economist at the Federation of Commerce of Sao Paulo (Fecomercio), credit cards represented 42 percent of outstanding debt in August. Moreover, the CB reported in September that loan maturities are at a six-year high, and that financing costs are declining. The average maturity for consumer loans is about 9 months, and 14 months for corporate loans. [Note: As a small comparison, the average maturity for a U.S. new car loan in August was 62 months. End Note.]

A New Breed of Creditors

¶4. (U) Marcelo Carvalho, Chief Economist at Morgan Stanley, told Econoff that one of the most noticeable changes in the Brazilian economy has been the growth in credit access especially for Brazilians of lower income. New forms of credit, such as payroll-linked credit have increased credit opportunities for lower income Brazilians. Payroll-linked credit lines, up 24 percent in 2007, automatically deduct payment from a paycheck at significantly lower interest rates. The Brazilian government introduced these loans in 2004 for government employees and retirees, and their interest rates are about half of traditional consumer loans.

Rate Cuts Don't Matter Much for Consumers

¶5. (U) The SELIC rate is the Brazilian reference interest rate, which is the intra-bank lending rate, but more directly determines what rate banks charge the government. Most consumer credit lines are not directly indexed to the SELIC rate; however, SELIC rate cuts indirectly lower borrowing costs for consumers and corporations. While the CB has cut the SELIC by 8.25 percentage points (a 42 percent drop) to 11.25 percent since September 2005, corporate and consumer rates remain high and have fallen by a lesser magnitude. The average annual corporate lending rate for August was 23 percent, and for consumers about 46 percent, down 30 and 35 percent respectively over the same time period.

¶6. (U) A cut in the SELIC rate does indirectly encourage lending to the private sector because banks capture higher profit margins than they would lending to the government. However, the lack of competition and underdeveloped regulations in the Brazilian banking sector limit consumers' benefits from a rate cut. Employees often are required to use specific banks to receive paychecks, limiting incentives to market to individual consumers. The banking sector is highly concentrated, which also restricts competition and lessens the effects of a cut.

¶7. (U) A Brazilian law preventing banks from sharing positive personal credit history reports also minimizes consumers' ability to switch banks seeking better rates. A positive credit history would increase the information available to lenders, reduce the default rate, and lower credit costs, but the Brazilian government has made little attempt to address the issue. Without a traditional credit score such as that in the U.S., all borrowers pay a default premium and thus interest rates are artificially high.

The Booming Economy the Real Driver

¶8. (U) Mariano told Econoff that the private sector's expectation for economic stability over the short and medium term is helping drive both the supply and maturity of consumer credit. This business optimism is due in part to interest rate cuts and is driving companies to find strategies to increase local demand for their products. On the demand side, the increase in workers' incomes and the creation of credit lines that deduct directly from

paychecks are propelling consumer credit growth.

Credit Growth Not a Concern Now, But...

¶9. (U) Generally speaking, credit expansion in Brazil is positive and helps to drive domestic economic growth; however, there are several long-term concerns. Ulisses Gamboa, an economist for the Commercial Association of Sao Paulo, told Econoff that Brazil's regulatory framework for credit checks is weak. On the retail lending side, stores perform basic credit checks before issuing credit cards; however, Brazil doesn't have an interstate system for checking credit history, so establishments must individually check each known state of residence. Furthermore, Gamboa noted the regulatory body absolves a person's bad credit history after 5 years.

¶10. (U) The delinquency rate for private consumers in Brazil has been fairly stable, approximately 7.2 percent in August. Overall, Brazil's delinquency rate is much lower than its Latin American counterparts. [Note: According to U.S. Federal Reserve data, the U.S. delinquency rate across all consumer loans for the second quarter of 2007 was about 3 percent. End Note.] Mariano told Econoff that the stable delinquency rate is partly due to the extended payment timeframes and lower interest rates. However, Fecomercio's monthly survey of consumer indebtedness and delinquency (PEIC) in Sao Paulo in August showed that 59 percent of respondents

were indebted, and 22 percent of those indebted are more than 90 days overdue. Over the longer term, Mariano is concerned that increased indebtedness could imply higher default levels and lead banks to restrict new credit availability or raise interest rates across the various credit products.

¶11. (U) The lack of personal finance skills among Brazilians who have recently gained access to credit sources as a result of higher incomes and financial reforms also is a potential source of concern. According to Mariano, the new profile of Brazilian consumers live month-to-month, and don't consider future savings or future income streams when making credit purchases. According to the Fecomercio survey, 36 percent said they were behind on payments because of a lack of financial control, and another 30 percent because of unexpected expenses. Furthermore, the common practice in Brazil of dividing purchases into a series of monthly payments encourages bigger and more purchases by postponing liabilities to a future date.

¶12. (U) Despite greater access to cheaper credit, an age-old mechanism for covering excessive monthly expenses called the "cheque especial" grew considerably. Banks provide an overdraft credit to meet immediate cash needs at much higher interest rates, near double the rate of traditional credit lines. [Note: The average interest rate for this line of credit in July was 139 percent. End Note.] Initially, demand for this service declined with cheaper credit options, but renewed demand suggests that it has become a last resort for people that have exhausted other forms of credit.

Comment

¶13. (U) Brazil's credit story reflects the positive business climate and indirectly the decline in real interest rates. Although growth has been strongest in relatively low-risk consumer segments such as vehicle and payroll loans, there remain risks associated with increasing the availability of credit to a new segment of the population. Overall, the total lending as a percent of GDP is low, and many economists in Sao Paulo are not concerned about the rapid growth of personal credit for the moment. As with any market liberalization, Brazil needs to address the regulatory framework to strengthen the Brazilian credit system in order to ensure stability in the rate of default and to bring interest rates down. End Comment.

¶14. (U) This cable has been coordinated with Embassy Brasilia and the Financial Attache.